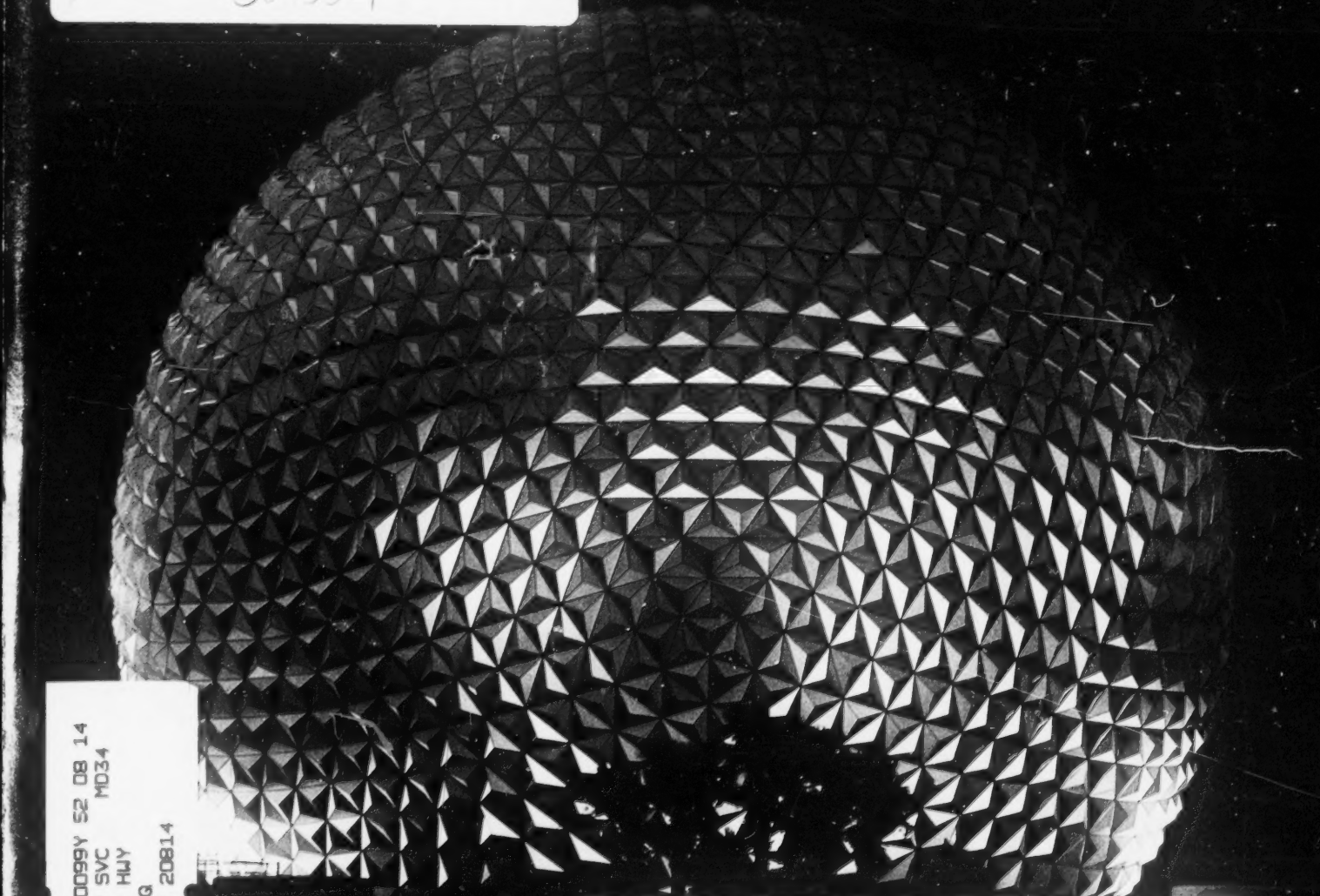
Do We Have Too Many Venture Capitalists?
How Sick Companies Endanger the Pension System
Japan's Computer Inc.

$3.00

October 4, 1982

FORTUNE

CS00-1 9/10/82



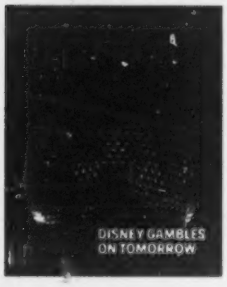
MAY88 000 ES5200999Y 52 08 14
CONGRESSNL INFO SVC MD34
4520 EAST-WEST HWY
STE 800 SRF ACQ
BETHESDA MD 20814

DISNEY GAMBLES ON TOMORROW

Spaceship Earth at the new Epcot Center

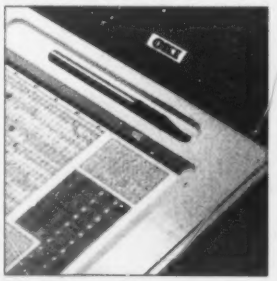
BEST AVAILABLE COPY

FORTUNE



The 180-foot-high polished aluminum sphere of Spaceship Earth, towering over the new Epcot Center at Disney World, was photographed by John Madere. Disney's high hopes for Epcot Center are examined in the article on page 62.

72 Pension Funds



82 Computers

98 Panama Pipeline

Departments

4 THE EDITOR'S DESK

7 IN THE NEWS
Bendix's Bill Agee up against a heavyweight, **RCA** taps a **GE** man as heir apparent, **Daimler-Benz**'s busy plants, **Intel** gets an endorsement from **IBM**, **John Brown** after Washington's pipeline sanctions, **Kemper Group**'s financial deli—and more

39 LETTERS TO FORTUNE
On diamonds in crisis, espionage at Harvard, the need for unions, the sea treaty, bank examiners, and other matters

51 FORTUNE FORECAST
Why the transition to high technology will slow growth in the 1980s

ACKNOWLEDGMENTS

4—Beth Baptiste. 13—Courtesy Mercedes-Benz. 39—Liam Roberts. 51,52—Chartmakers Inc. 74—Jerry Pinkney. 122—Judi Mintzer. 139—John Huehnergarth. 157—Chart by Patricia Byrne, illustration by David Hake. 158—Illustration by David Hake.

FORTUNE (ISSN 0015-8259), October 4, 1982, Vol. 106, No. 7. Issued biweekly by Time Inc., 3435 Wilshire Blvd., Los Angeles, Cal. 90010. Second-class postage paid at Los Angeles, Cal., and at additional mailing offices. Subscriptions: U.S., U.S. possessions: one year $36; Canada: one year $46; elsewhere: one year $42 to $70. Single copy $3. Address all subscriptions and correspondence concerning them to FORTUNE, 541 North Fairbanks Court, Chicago, Ill. 60611. Principal offices: Time & Life Building, Rockefeller Center, New York, N.Y. 10020. Address correspondence concerning editorial material to FORTUNE, Time & Life Building, Rockefeller Center, New York, N.Y. 10020. J. Richard Munro, President, J. Winston Fowlkes, Treasurer, Charles B. Bear, Secretary. Authorized as second-class mail by the Post Office Department, Ottawa, Canada, and for payment of postage in cash; Mexico: Autorizado como correspondencia de segunda clase—registro DGC-Num. 051 0881, características 226251415, por la dirección general de correos de México. Responsable en México para efectos postales: Carlos Ruz Pliego, Leibnitz 13, México D.F. 11590. Member, Audit Bureau of Circulation. POSTMASTER: Send address changes to FORTUNE, Time & Life Building, 541 North Fairbanks Court, Chicago, Ill. 60611. © 1982 Time Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. FORTUNE is a registered mark of Time Incorporated.

131 Steel

136 Environmentalists

55 KEEPING UP
A parlay on the future, sex discrimination in the Bible, caviling with Kemp, and other matters
by Daniel Seligman

157 PERSONAL INVESTING
Yes, you can buy a market average
by Mary Greenebaum

165 ON YOUR OWN TIME
A stylish reward for saving French art
by Marilyn Wellemeyer

177 BOOKS AND IDEAS
The future according to Herman Kahn
by Herbert Stein

COMPANIES
62 Disney Gambles on Tomorrow *by Irwin Ross*
With $900 million and oceans of hoopla, Walt's successors bet that Disney World's Epcot Center will bring back the glory days.

TROUBLE
72 How Sick Companies Are Endangering the Pension System *by Geoffrey Colvin*
A recent spate of defunct plans, along with the possibility of worse to come, have highlighted potentially fatal flaws.

JAPAN
82 Here Comes Computer Inc. *by Bro Uttal*
The government-backed fifth-generation project is the country's bold and risky bid to go from follower to leader in the computer industry.

91 The Man from MITI Speaks His Mind
Shintaro Abe, chief of the powerful ministry, believes in free trade—and also in good old-fashioned national self-interest.

PICTURE PORTFOLIO
98 Oil Cuts a Path Across Panama
A new pipeline over savannas, mountains, and swamps will save tankers a five-day round trip through the canal.

MANAGEMENT
106 Do We Have Too Many Venture Capitalists? *by John W. Dizard*
The answer seems to be yes—or at least we have too many with too little talent.

HOUSING
121 The Other Way Builders Make a Buck *by Gurney Breckenfeld*
It's mortgage banking. In homebuilding's worst year since 1945, the profits have provided a big lift.

NEW PROCESSES
131 A German Maverick Pioneers in Steel *by Robert Ball*
Willy Korf has prospered by backing his technological hunches. His latest: a low-cost process that uses steam coal to make pig iron.

LOBBIES
136 Washington in the Grip of the Green Giant *by William Symonds*
The environmental superlobby is now as potent as the National Rifle Association or the right-to-life movement.

TROUBLE

How Sick Companies Are Endangering the Pension System

If many of their retirement plans topple, the government agency that insures them could go broke.

by GEOFFREY COLVIN

On August 20, three months after its celebrated bankruptcy, lawyers for Braniff International showed up in a Fort Worth federal court with more bad news. Four of Braniff's pension funds, it seems, needed at least $164 million to pay the employees all the future retirement benefits they had been promised. Unfortunately, the funds had assets worth only about $106 million. If the news caused any employees to reel with visions of living out their golden years in boxcars, they were surely relieved to learn that their pensions are safe—insured by the Pension Benefit Guaranty Corporation, which Congress created in 1974 for just such cases.

But while the future looks secure for Braniff pensioners, the PBGC's future is not. Assuming the court declares the pension funds in default, the PBGC will be hit with one of the biggest unfunded pension liabilities it has had to catch. The biggest so far is the $56 million it inherited following the failure of White Motor. Just two weeks ago another large plan went over with a heavy thud when Rath Packing, a long-troubled Iowa meat processor, told the PBGC it intends to fold its plan, which has an unfunded liability of $41 million. Smaller plans are also raining down on the PBGC in growing numbers—130 in the last 11 months—the result of business failures that have lately reached Depression-era levels. Up to now the PBGC has caught all the fallen plans, and there's no immediate danger of it collapsing under the strain. But the recent spate of defunct plans, plus the scarifying and hardly unthinkable prospect of a monster liability like Chrysler's coming in, have highlighted flaws in the pension insurance system. They have been there all along and could eventually threaten the PBGC's ability to do its job.

Research associate: Robert Steyer

Fixes are in the works

Several proposed solutions are now circulating in Washington, some of them in a bill before Senate and House committees. Regardless of which fixes are adopted, and some probably will be, it looks as if the private pension system is in for fundamental changes that will affect all companies with pension plans—and not just companies in trouble.

Congress begat the current worrisome situation when it passed the Employee Retirement Income Security Act in 1974. It meant well. Before ERISA, employees of a failed company like Braniff were usually left out in the cold. Further, it wasn't even necessary for a company to go bankrupt to strand employees without pensions they had been promised; the company could end its pension plan whenever it liked. The most notorious example occurred in 1963 when Studebaker closed its South Bend car factory and stopped payments to the seriously underfunded plan that covered the workers. Only those already retired or on the verge of retirement got the pension benefits they had been counting on. Others got only a fraction—or nothing.

Spurred by the Studebaker case and a tendency of some corporate managements to make bighearted pension promises their successors would have to fulfill, Congress decided to insure the type of private pension plan most workers rely on for retirement income. This is called a defined-benefit plan because the company promises the employee a specific pension, usually based on pay and years of service. Such plans now cover 36 million workers.

The PBGC's job is to act as an insurance company, collecting annual premiums from defined-benefit plans. A company can still walk away from an underfunded plan, but it must then hand over up to 30% of its net worth to repair the deficit. The PBGC fully guarantees only benefit promises that have been in effect for at least five years and guarantees them only up to cer-

tain limits. The insured amount is usually about 85% of the total benefits promised under a plan. Still, as retirees, most workers end up getting nearly all of what's promised to them. For a notable exception, see the box on the next page.

The system has worked fine so far, but it contains a couple of time bombs that could go off sometime soon. One is the premium setup, which has never made sense. From the beginning the annual premium per participant has been the same for all plans, ignoring the fact that some plans—such as those that have big unfunded liabilities and sick corporate parents—pose far greater risks to the system than others.

The PBGC should ask Congress for authority to make the system fair by imposing a risk-related premium. The agency has been reluctant to take on the job of assessing such risks, which is particularly tough but not undoable. The PBGC also argues that a truly fair premium for companies like International Harvester and Chrysler might lead them to terminate their plans. But the premium change could be phased in gradually, and over time would encourage all companies to put their plans on a sound footing.

In addition, the premium has never been high enough. It started out at $1 a year for each worker covered and has since risen to $2.60 but still doesn't come close to generating the funds the PBGC might need. The agency estimates that by year-end its deficit—in essence, its own unfunded liability—will total $236 million. If any of those large plans in the table on the next page should fold, the PBGC's deficit could mushroom overnight.

Bailing out on the cheap

The second ticking bomb is the rule covering companies that end their plans. Having to turn over 30% of net worth sounds like quite a deterrent, but in some cases that provision *encourages* sick companies to end ailing plans. If a company has a plan with an unfunded liability of $50 million, for example, and its net worth is $30 million, it could end the plan, give $9 million (30% of $30 million) to the PBGC and be

TEMPTATIONS TO PASS THE PENSION BUCK

Company	Unfunded pension liability* (in millions)	Cost to company if it abandons plan (in millions)	Potential PBGC liability (in millions)
CHRYSLER	$1,658.2	$211.1	$575.1
UNIROYAL	$434.8	$70.7	$219.1
WHEELING-PITTSBURGH STEEL	$292.0	$21.2	$175.5
INTERNATIONAL HARVESTER	$560.4	$48.5	$86.4

*Estimated by Hewitt Associates

Under present law, which urgently needs revision, many companies with underfunded retirement plans can come out strikingly ahead by unloading them on the government's Pension Benefit Guaranty Corporation. They have to cough up 30% of net worth, but for the companies shown here it might be a good deal.

rid of a $50-million liability plus the annual contributions.

The only company that appears to have made it through the loophole so far is AlloyTek, a small producer of jet engine components in Grand Rapids, Michigan. In late 1979 AlloyTek ended its underfunded defined-benefit plan out of "economic necessity," according to President Ray Fountain, 44. "We were in very precarious financial straits," he says. "We had a big problem in borrowing because of our unfunded pension liability."

The plan was $4.5 million under water, and since the company said it had no net worth—30% of which obviously equals nothing—the PBGC stood to inherit the whole liability. But when AlloyTek started a new plan, the PBGC refused to accept the liability of the old one, arguing that AlloyTek hadn't really dropped its retirement plan at all—just its liability. The PBGC settled some issues out of court last year on terms that seemed favorable to AlloyTek. The company agreed to drop its new plan but soon replaced it by contributing to Individual Retirement Accounts, which are free of PBGC regulations. The PBGC may still dispute AlloyTek's claim of no net worth, but whatever the outcome, the bulk of that $4.5-million liability now belongs to the PBGC. AlloyTek says chucking the liability saved its life.

International Harvester's shadow

While AlloyTek's situation may have been unusually desperate, the looming possibility is that some of the biggest troubled companies might now follow the legal trail it has blazed. That possibility grew considerably more credible with Rath Packing's recent action, which was precisely along these lines. Its unfunded liability of $41 million compares with a net worth of about $1 million.

The move is still far from an easy out. A strong union might be able to cite a contract provision to block use of the loophole, and the action would hardly enhance a company's reputation as a keeper of its word. But for some it could still be worth it. According to Dallas L. Salisbury, 33, director of a Washington think tank called the Employee Benefit Research Institute, the main reason for the current concern about the PBGC is "the fear of the Harvesters of the world voluntarily terminating their pension plans when they know that 30% of net worth may be a very good deal."

As the table shows, that could throw some painfully heavy liabilities onto the PBGC. There wouldn't be any immediate threat to the PBGC's ability to pay out benefits because those liabilities are spread over 40 or 50 years. The PBGC's present assets plus those it would take on would enable it to continue paying benefits for five years or more. But to avoid a cash crunch down the road, it would have to raise its premium now—and the increases could be dramatic. The PBGC has already asked Congress for an increase to $6 per covered worker. Depending on which plans were folded and when, it could have to ask for $10, $20, or more.

Those are still small sums compared with total pension costs, but companies with healthy plans could become indignant about subsidizing losers. Sound companies might move in increasing numbers to so-called defined-contribution plans, which have grown more alluring since ERISA was passed. Under them, an employer promises only to pay a certain amount into the fund every year, and the fund's assets are invested. How much a worker gets at retirement depends on how the investments are doing. Such plans are less regulated than defined-benefit plans and aren't insured by the PBGC.

With the strongest plans leaving the insurance system, the weak plans would be left to support each other, which obviously wouldn't work for long. Carried to its most chilling extreme, this scenario has the pension insurance system in ruins and Congress stepping in to guarantee pensions out of general tax revenues—in return, perhaps, for more regulatory power.

The PBGC's plight could get even worse unless the earning power of the pension funds remains at recent high levels. Interest rates have a powerful effect on the value of a pension plan's liabilities. Pension plan administrators must figure out how much they need today to cover liabilities that extend decades into the future—an amount called the present value of the benefits. When interest rates are extremely high, as they have been until recently, the

continued

Harding Lawrence Has a Problem

When Harding L. Lawrence, 62, was forced out as chief executive of Braniff International two years ago, he at least had the solace of a $306,000-a-year pension—or so it seemed. Now Braniff has filed for reorganization under Chapter 11 and has asked a judge to declare four of its pension plans, including the one covering Lawrence, in default. Assuming that happens, Lawrence will see his pension go into a dive almost as steep as Braniff's own. Lawrence's new pension couldn't be more than the maximum now paid by the government's Pension Benefit Guaranty Corporation, which would take over the plans: $16,568 a year.

As a private attorney, Edwin M. Jones, 65, specialized in pension matters. Now he runs the Pension Benefit Guaranty Corporation, which has found 30 major firms that might want to leave their underfunded pension plans at his door. If they did, he says, "PBGC estimates it would suffer $3.1 billion in losses." And that would make employers' insurance premiums skyrocket.

present value of the benefits is relatively low because it takes a smaller portfolio of securities to yield enough income to meet the pension obligations. But when rates fall, the present value of benefits can skyrocket. The PBGC now assumes an 11% rate—the highest in its history, though it should eventually fall, as other rates have. FORTUNE has assumed a 10% rate in the table on page 74.

The precise relationship varies with each plan, but a drop in interest rates from 10% to 7%, for example, would in most cases raise the present value of the benefits by at least 50%. Of course, a drop in rates should also cause the pension fund's assets to increase in value—witness the recent stock market boom when rates tumbled—but in practice they don't increase as much as the liabilities. So while those potential PBGC liabilities in the table may look frighteningly large, they could easily get a lot larger.

Before they balloon would be the best time to fix the system with a few changes in the law. A risk-related premium is one needed reform, and another is to close that giant loophole through which companies can walk away from their plans. Congress could do that by requiring the PBGC to rescue a plan only when a company was truly defunct and in liquidation. If a company terminated its underfunded plan but stayed in business, it would have to make up the underfunding—completely—over a period of years. Even filing for bankruptcy wouldn't dump the liability on the PBGC, since a company could conceivably file, reorganize, return to health, and eventually get its pension plan back up to strength.

That proposal is part of a bill introduced in the Senate by Don Nickles, an Oklahoma Republican, and in the House by John Erlenborn, a Republican from Illinois. The proposal has the support of the Reagan Administration and the ERISA Industry Committee, a lobbying group of 115 major corporations with healthy pension plans that want to keep their premiums down. It is also backed by the U.S. Chamber of Commerce and the National Association of Manufacturers.

The bill includes other changes that aren't so strongly supported. It would in some cases give the PBGC the status of a general creditor when a company goes bust, an idea the PBGC is pushing but one that gives many executives the willies. It could make the unfunded pension liability of even a stalwart company a major factor in the company's ability to get credit.

The bill would also make it nearly impossible for a big company to sell or spin off a subsidiary with a weak plan and avoid all liability if the unit ends the plan or goes under. It's not clear that a company can expect to get away with this now, but a few have. The bill would make the parent liable for up to 15 years.

Though the bill probably won't go far this year, action next year seems likely to many pension lobbyists. But those less popular provisions would probably have to be watered down. As Dallas Salisbury notes, "They're controversial enough that they could readily keep you from getting a loophole closed—the main loophole."

Marriage for keeps

If Congress manages to close the loophole it will deeply alter the relation between a company and its plan by completing a change that began with the passage of ERISA. Previously a company could set up a plan and then simply cast it aside if it became burdensome. ERISA still lets a company divorce its plan, but at a cost—forfeiting that 30% of net worth. The final step is to treat the pension promise like any other company promise to pay. Company and plan would be bonded, in effect, till death us do part.

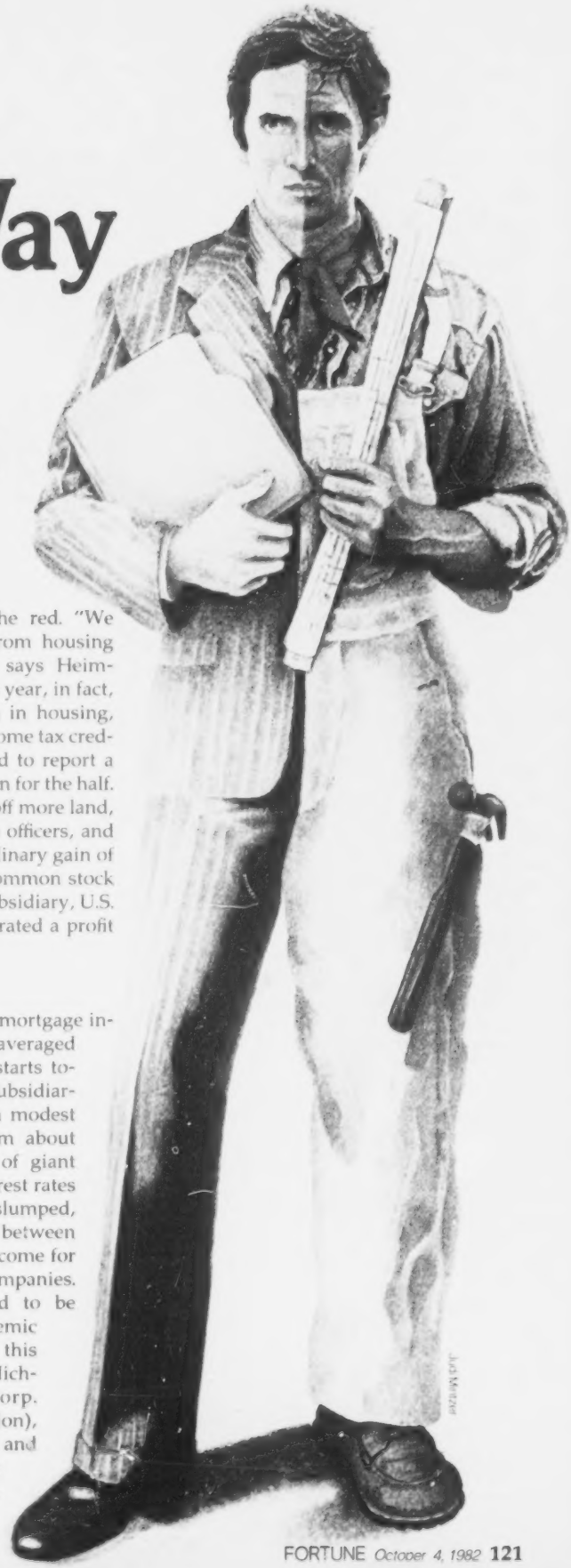
The mere prospect of that is already causing companies to weigh their pension vows more seriously. Some now consider the plan an important element of finance rather than part of the "human resources" department. Other companies, shifting to defined-contribution plans, have decided not to make such vows at all.

While that trend worries the PBGC, there's a way to prevent the shift away from defined-benefit plans from growing into a stampede. That's to make the premium adequate and risk-related, and to put a stopper in the big loophole. The result would be a stronger and more equitable insurance system that would leave the PBGC—and most of those who pay its premiums—better off. ■

HOUSING

The Other Way Builders Make a Buck

by GURNEY BRECKENFELD



In their struggle to remain afloat financially during the housing industry's worst year since 1945, quite a number of the largest homebuilding companies have been enjoying a big lift from a surprising source. Profits from their mortgage banking subsidiaries have cushioned the impact of plunging sales and swollen inventories of unsold houses.

That is an extraordinary reversal of what's normal among the building giants. In good times their profits from homebuilding dwarf their profits from mortgage banking, which involves advancing loans to home buyers, selling those loans to investors, and, in most cases, collecting and passing along the monthly payments from the borrowers. As this bundle of activities makes clear, the term mortgage banking is something of a misnomer, since its practitioners usually have only modest capital of their own and serve mainly as conduits.

With housing as sick as it is, the new eminence of mortgage profits is not surprising to the builders themselves. In the words of Isaac Heimbinder, senior vice president for finance at U.S. Home Corp., "Any builder with a financial services company would look to that company to throw off a disproportionate amount of money nowadays."

That is certainly the case with Houston-based U.S. Home, the nation's largest builder of one-family houses. The company operates in 135 cities in 18 states. Its revenues last year came to $982 million, but only the sale of land and lots kept its housing divisions out of the red. "We haven't made any money from housing operations in 12 months," says Heimbinder. In the first half of this year, in fact, U.S. Home lost $1.1 million in housing, even after allowing for an income tax credit. Yet the company managed to report a net profit of nearly $2.8 million for the half. Among other things, it sold off more land, canceled a bonus plan for its officers, and managed to book an extraordinary gain of $2 million from swapping common stock for debt. And its mortgage subsidiary, U.S. Home Mortgage Corp., generated a profit of $1.4 million.

The tonic got stronger

As recently as 1979, when mortgage interest rates on new houses averaged just over 11% and housing starts totaled 1.7 million, mortgage subsidiaries were apt to make only a modest contribution—anywhere from about 2% to 20%—to the profits of giant builders. But last year as interest rates climbed and house sales slumped, mortgage banking produced between a quarter and a half of net income for some large publicly held companies.

Mortgage banking proved to be even stronger tonic for anemic earnings in the first half of this year (see chart next page). Michigan-based Pulte Home Corp. (1981 revenues: $387 million), with operations in 12 states and Puerto Rico, wrested nearly a third of its shrunken $4.1-

Mortgages to the Rescue

Profits from mortgage operations as percent of total profits

These five big homebuilding enterprises have been bolstered by their mortgage subsidiaries in the last couple of years. That has been a common pattern among big builders, whose profits from house sales are badly depressed. Weyerhaeuser Real Estate does not report net profits (only pretax); the chart percentages for that company are based on FORTUNE estimates. At U.S. Home, Pulte, and American Continental, results for the first half of this year included unusual income bulges, and these required judgment calls in the calculation of chart figures. In all three instances, FORTUNE treated the special income so as to understate, rather than overstate, the mortgage subsidiary's contribution to overall net.

million net profit from mortgage finance. Phoenix's American Continental Corp. (1981 revenues: $302 million), which sells some 60% of its new houses in Colorado and another 30% in Arizona, earned 42% of its profit from mortgages. The Maryland-based Ryland Group ($231 million), which added mortgages to its activities only four years ago, earned 29% of its first-half net from that source.

The reward of mortgage operations was even more dramatic for another housing giant, Pittsburgh-based Ryan Homes Inc. (1981 revenues: $381 million). Ryan lost $538,000 in the first half of 1982, but the deficit would have been a lot larger without the $1.9-million profit of subsidiary Ryan Financial Services. "We wouldn't have survived very well without it," observes Malcolm Prine, chairman and chief executive of Ryan Homes.

Fat was attractive

All ten of the nation's largest builders of houses have mortgage subsidiaries. So do at least another 16 among the 56 companies with $100 million or more in annual revenues from houses, mobile homes, apartments, and prefabricated housing (known in the trade as manufactured housing).

Research associate: Sue Zelony

Most of the housing giants branched into mortgage banking about a decade ago, not primarily to make money on mortgage operations but to help sell houses. Having a mortgage company enabled them to offer their customers faster loan decisions or better access to money in parts of the U.S. where there were only a few local lenders. Once solidly established, most mortgage companies found that profits came easily in those days. According to one veteran mortgage executive, the companies often made 18% on equity in good years, 12% on average, and 6% even in bad years.

As might be expected, fat profits attracted new entrants. Back in the Sixties, before the influx of homebuilders and other newcomers, most mortgage bankers were independent businessmen, but today only 22 are left among the nation's 100 largest mortgage concerns. Commercial banks and bank holding companies have been so busy acquiring mortgage companies in recent years that they now own 48 of the top 100. In addition, Sears Roebuck owns two and industrial corporations six. One notable industrial owner is Weyerhaeuser, the big timber company. Its subsidiary Weyerhaeuser Real Estate Co. owns nine homebuilders as well as Weyerhaeuser Mortgage Co. The mortgage outfit is the nation's second largest, with a $7.8-billion portfolio after recently acquiring most of the single-family mortgages of Mason-McDuffie Co., a California real estate firm.

The increasing competition generated by this influx of big companies is part of an enormous upheaval that has transformed the once staid and simple mortgage banking business into a complicated sector of high finance. Managers must cope with the array of variable-rate, graduated-payment, and shared-appreciation mortgages that have partly replaced long-term fixed-rate loans. Wall Street investment houses have moved into the business as underwriters of mortgage-backed securities and, in some cases, as owners of mortgage companies. Eli Broad, chairman of Los Angeles-based Kaufman & Broad, No. 9 in homebuilding, observes that mortgage banking "is becoming a money-trading operation, with Salomon Brothers in the thick of it rather than the old-school type of mortgage banker."

Where the profit comes from

The intricacies of dealing with new kinds of loans and new ways of selling them to institutional investors leave little room nowadays for the plodding managers for which mortgage banking was once famous. An executive smart enough and

continued

BEST AVAILABLE COPY

knowledgeable enough to run a mortgage subsidiary well can command an annual salary of $75,000 to $125,000. A few are paid more. Even with a bare-bones staff of six or seven, plus rent and utilities, it is likely to cost at least $500,000 a year to run a minimum-sized mortgage operation. Accordingly, mortgage subsidiaries are uncommon among smaller homebuilders—there would not be enough loan volume to produce an adequate return.

Putting loans on the books is not the profit-laden part of the business. Most mortgage companies lose money on originations, as they are called, because the costs exceed the normal fee, 1% of the loan. Builders have two cost advantages: they need no marketing to drum up mortgage business, and the salesperson who sells a house can fill out a mortgage application at the same time. Some builders say they pay the overhead with originations.

The steady and reliable profit, though, comes from servicing—collecting those monthly payments and dealing with delinquent borrowers. The prevailing fee is ⅜ of 1% per year of the declining balance of the mortgage loan. Because of their overhead costs, most mortgage companies do not reap substantial profits until their portfolio of loans being serviced passes about $200 million.

The record of Pulte Home's ICM Mortgage Corp. illustrates the profit buildup. In 1977, with a portfolio of $80 million and mortgage originations of $76 million, ICM netted a mere $244,700. By 1979, with servicing up to $377 million and originations of $221 million, profits came to $679,000. Last year servicing reached $836 million and originations $296 million; profits leaped to $4.49 million.

At that size a mortgage arm becomes a strong buttress for a builder's main business. He has access to more sources of mortgage funds, and the size of his mortgage company enables him to borrow money in big chunks on Wall Street for as much as 100 basis points less than a small builder might be able to arrange for his customers from a local bank or savings and loan. In July, for example, when the average rate on conventional mortgages was 17.2%, Ryan Homes floated a $20.9-million bond issue at 16%.

Builders can use the spread to fatten their profit margins or, as many have been doing, to subsidize mortgages for their customers by giving them below-market rates. All forms of these "buy downs" are costly. Last year U.S. Home spent $80 million—nearly 9% of its revenues and nearly eight times its net profits—to subsidize mortgage loans in an effort to maintain its front-ranking share of the market.

The biggest and most important change in mortgage banking, especially for homebuilders, is the emergence of the bond market as the No. 1 source of mortgage money. Federal Reserve figures show that 42% of the new money for home mortgages came from the bond market during the first quarter of this year, compared with only 7% in 1977. Savings and loan associations, the historic leader, were so crippled by losses that they provided only 8.6% of the first-quarter total.

Help from a split

Builders tried from the mid-Fifties on to devise a way to convert mortgages into securities acceptable to bond buyers. Their efforts finally succeeded after the 1968 Housing Act split the government's Federal National Mortgage Association into two parts. FNMA, better known as Fannie Mae, was rechartered as a privately owned

continued

$1,000 Minimum

SCUDDER
Money Market Funds

Scudder's three money market funds help individuals, organizations, businesses, IRA and retirement plan participants, and others keep their money working hard, but never tied up. High yield. Free checkwriting. Telephone redemption. No penalty for redeeming shares whenever you wish. No sales charge. Free exchange into Scudder's growth, income, and international funds. Backed by Scudder, Stevens & Clark's 63 years of investment counsel experience.

☑ Check the fund that's best for you.

Please send me information on:

☐ **Scudder Government Money Fund**
● U.S. Government guaranteed securities

☐ **Scudder Cash Investment Trust**
● High quality money market securities

☐ **Scudder Tax Free Money Fund**
● Tax-exempt municipal securities *

CALL TOLL FREE or **WRITE** *for prospectuses which contain more complete information, including management fees and expenses. Read material carefully before you invest or send money.*

1-800-453-1905

Scudder Fund Distributors, Inc.
175 Federal Street, Boston, MA 02110

Name_____
Address_____
City_____
State_____ Zip_____

Yields are a function of type and quality of investment, portfolio maturity, and the Fund's operating expenses, and may fluctuate daily. Funds' shares are not insured.
*Some income may be subject to state, local or federal taxes.

but partly government-supervised corporation. Its main role is to help level the swings in the availability of mortgage credit by buying (or selling) mortgages on a gigantic scale in the secondary, or resale, market. The other half of the old organization became the Government National Mortgage Association (Ginnie Mae), an agency of the Department of Housing and Urban Development. Ginnie took over Fannie Mae's former job of making mortgage loans with Treasury money for HUD's subsidized housing programs. The law also gave Ginnie Mae a new device to snare private capital for both subsidized and unsubsidized FHA and VA loans. By stamping on her guarantee, Ginnie places the full faith and credit of the government behind securities backed by pools of FHA and VA mortgages.

Ginnie Mae issues, which carry an AAA Standard & Poor's credit rating thanks to their federal guarantee, have unlocked the door to the bond market for a broad array of mortgage-backed securities. First issued in 1970, GNMAs now aggregate nearly $136 billion. In addition, some $46 billion of securities backed by conventional mortgages have been issued by the Federal Home Loan Mortgage Corp., nicknamed Freddie Mac. Besides all that, banks, savings and loans, mortgage bankers, and homebuilders have floated more than $5 billion worth of similar paper by dealing directly with bond underwriters.

"They went to school on us"

Though there are numerous variants, mortgage-backed securities come in two basic types. One provides ownership in a pool of mortgage loans. The second is a bond secured by a pledged pool of mortgages. For builders, the difference is crucial. By issuing the second type, generally through a subsidiary shell formed for the purpose, they usually retain legal ownership of the underlying mortgage loans. If so, the proceeds of the bond issue may qualify for income tax purposes as an installment sale—instead of an outright sale—and that shelters a large portion of those funds from immediate taxation. Taxes come due only gradually, as amortization reduces the outstanding principal of the mortgage loans. Kenneth Leventhal & Co., a Los Angeles accounting firm that specializes in financial innovation in real estate (see "Architects of Exotic Mortgages," FORTUNE, December 29, 1980), figures that a builder big enough to float $95 million of mortgage-backed bonds might be able to shelter $7.5 million of a $10-million taxable gain. No wonder several big builders have issued mortgage-backed bonds this year, copying the technique from one another. Says Robert Horner, a senior vice president at Pulte: "Ryan's recent $20-million issue with Smith Barney is almost a duplicate of ours. They went to school on us. But that's all right. We went to school on another company."

U.S. Home and Pulte have been able to sell mortgage-backed bonds at lower interest rates than those prevailing on Wall Street by marketing through regional underwriters. Pulte, for instance, floated a 30-year issue of GNMA collateralized bonds in July at 14%. The bonds are sold in minimum packages of $1,000, aiming at individual purchasers such as owners of small businesses rather than institutions able to buy in $25,000 blocks, the minimum for most securities underwritten by big Wall Street investment houses.

Smaller builders, too, are trying to float mortgage-backed bonds. They expect to act in groups, some of them coached by

continued

HAZARDOUS WASTE CONTROL

You know us by our work, now know us by our name.

Proper management and clean-up of hazardous waste has become a major industrial challenge of the eighties. URS Engineers continues to provide preventive planning, hazard assessment, design and construction supervision of hazardous waste systems, together with clean-up supervision. Learn more about how we can help you. Write or phone

URS ENGINEERS

155 Bovet Road San Mateo, CA 94402 415/574-5000

PROJECTS FOR PEOPLE

Please write for employment opportunities

one-sixth page

IF YOU'RE AN ADVERTISER WHO NEEDS A LITTLE SPACE LIKE THIS ONE-SIXTH PAGE, CALL YOUR NEAREST FORTUNE SALES OFFICE TODAY. YOU'LL FIND OUT YOU DON'T HAVE TO SPEND A LOT TO REACH THE PEOPLE WHO DO SPEND A LOT.

ATLANTA (Southeast) (305) 231-0300
BOSTON (617) 267-9500
CHICAGO (312) 329-7840
CLEVELAND (216) 522-1212
DALLAS (214) 387-8555
DETROIT (313) 875-1212
LOS ANGELES (213) 385-8151
NEW YORK (212) 307-4801
PHILADELPHIA (215) 667-9550
PITTSBURGH (412) 261-3525
SAN FRANCISCO (415) 982-5000

OUTSIDE THE U.S.

LONDON Charles E. Florman 499-4080
DÜSSELDORF 0211-80511
TOKYO (03) 270-6611
HONG KONG (Asia, ex-Japan) Malcolm Clinch 5-273525
MILAN Dr. Giuliano Bleu 79.90.58, 78.16.28
PARIS Régie Expansion 7631211

FORTUNE

THIS DEVICE MAKES ORDINARY TELEPHONES OBSOLETE.

Actual size.
(1" x 5⅛" x 2¼")

The Freedom Phone® Cordless Telephone Model FF-3500 has more features than any ordinary telephone. But one ordinary feature is missing.

There's no cord to tie you down. The compact handset measures 1" x 5⅛" x 2¾" and weighs just 7 ounces. So it's really easy to take or make calls anywhere within its operational range. That's upstairs, downstairs, in the front yard, backyard, at the neighbors, up the street, or down the block.

Instead of going to the phone to talk, you take the phone with you.

The Freedom Phone 3500 is the first cordless telephone that's small enough to fit in your pocket.

Designed and built exclusively for the Electra Company, makers of Bearcat® Scanners, the Freedom Phone 3500 provides crisp and clear cordless calls. An audible tone and pulsing light confirm dialing. The touch of a button automatically redials the last number entered.

The Freedom Phone Cordless Telephone is as easy to install as it is to use. Its attractive and compact base station plugs into your existing phone line and electrical outlet.

If the idea of using a Freedom Phone Cordless Telephone has a nice ring to it, get up, walk to your obsolete telephone, and call ***800-4-4-P-H-O-N-E.*** *You'll learn more about the Model FF-3500 and get the name of the nearest Freedom Phone Dealer.*

THE FREEDOM PHONE® CORDLESS TELEPHONE.

Electra Company
Division of Masco Corp. of Indiana
300 East County Line Road • Cumberland, Indiana 46229

© 1982 Masco Corp. of Indiana

The effects of TIM would be far from tiny.

Leventhal & Co., to amass big enough packages of mortgages to qualify for the big time. Wall Street underwriters consider $40 million the minimum for a successful public offering to large investors, chief among them the long-sought pension funds with their $780 billion of assets.

The Reagan Administration is at work on a plan that could greatly expand the market for securities backed by conventional mortgages. Congress will be asked to authorize creation of Trusts for Investment in Mortgages. With a TIM, a lender will be able to pool any residential first mortgages as underpinning for investment-grade securities, provided they are registered with the Securities and Exchange Commission or meet the criteria of the Home Loan Bank Board. Just as important, the legislation, if enacted, will clear away legal underbrush that hampers sales of mortgage-backed paper other than that of federal agencies.

Big is better

Whatever comes of TIM, the institutional upheaval in mortgage banking seems certain to endure. To obtain loans for their customers at the lowest possible interest rates, builders will have to be more and more involved in mortgage activity—alone if they are big, in concert if they are small. A well-regarded authority in this matter is Barbara T. Alexander, a Smith Barney vice president and analyst who first alerted the financial community to the new role of mortgage subsidiaries in lifting big-builder profits. Alexander contends that mortgage operations will prove even more helpful to big outfits if home sales rebound. Her view finds considerable support among builders.

For several years large-scale builders have gradually been increasing their share of the total market at the expense of smaller rivals. Given superior access to money along with cost savings from bulk purchasing and quick construction, Alexander reasons, big companies will be able to extend their market-share gains. If so, they will be able to increase their sales dramatically in a housing recovery. F

LOBBIES

Washington in the Grip

of the Green Giant

Business's push for environmental deregulation is suddenly going nowhere.

by WILLIAM SYMONDS

Since President Reagan and the first Republican-controlled Senate in a generation took power in Washington, many of the liberal ideas and programs that flourished in the Sixties and Seventies have faltered. One that hasn't is the environmental movement, which has not only hung on to its public support but become so much stronger and more sophisticated that it deserves being ranked with the National Rifle Association and the right-to-life movement as a superlobby.

More than a dozen major environmental groups—backed up by scores of lesser ones—now roam the corridors of power in Washington. Their professional staffs number in the hundreds, and like the New Right they have become experts at using direct mail to raise money and generate grass-roots pressure on Washington from a highly motivated mass membership that exceeds five million. As a result, efforts by the Administration and business to reform environmental laws have been stopped dead in their tracks.

Gathered in the Washington headquarters of the National Wildlife Federation are top officials of most of the 14 groups that are the core of the environmental lobby. Front row, from left: Michael Bean, senior attorney, Environmental Defense Fund; Brock Evans, vice president for national issues, National Audubon Society; Charles Clusen, conservation director, Wilderness Society. In rear, from left: John R. Lorenz, executive director, Izaak Walton League of America; Elizabeth Davenport, coordinator, Environmental Action; Richard Munson, director, Solar Lobby; Jay D. Hair, executive vice president, National Wildlife Federation; John McComb, director, Washington office, Sierra Club; Paul Pritchard, president, National Parks & Conservation Association; Louise Dunlap, president, Environmental Policy Center.

Photograph by Neal Slavin

The environmentalists' rise to superlobby status has gone largely unnoticed; their recent achievements have been written off as a passing reaction to Reagan's controversial Secretary of the Interior, James Watt. In truth, the lobby played a big role in shaping Watt's negative image and so in generating the reaction to him that has fueled its victories in Congress, which have been little short of sensational:

■ Both the House and Senate recently extended the Endangered Species Act for three years without any significant changes. This is the law that in the late Seventies blocked completion of the Tellico Dam in Tennessee for two years to protect an obscure fish called the snail darter. It had been ridiculed as the ultimate example of environmental extremism, and even environmentalists expected it might be weakened when it came up for review this year. Then the green lobby organized a committee of several thousand scientists to educate Congress about protecting species, and a strong reauthorization sailed through both chambers on a voice vote.

■ After Watt tried to permit some oil and gas leasing in wilderness areas, environmentalists stirred up such a ruckus that, as a compromise, he proposed a bill that would bar such leasing until the year 2000. In August the House instead voted by a 6-to-1 margin for an environmentalist-backed bill to prohibit oil, gas, and some mineral leasing in wilderness areas forever. The environmentalists put on such "an intensive effort in terms of personal contact and mail," says an oil industry lobbyist who opposed the House bill, that "every time we were on the Hill we would find their tracks."

■ The environmentalists' National Clean Air Coalition has all but dashed the hopes of the Reagan Administration and many business executives that Congress would make major changes in the Clean Air Act. Recently the Senate Environment and Public Works Committee voted 15 to 1 to report out a tough clean air bill. John Quarles, the former EPA deputy administrator who is now head of a major industry and labor coalition working for change, characterizes the bill as "unacceptable to industry—and totally unacceptable to the auto, utility, and mining industries."

Frustration at the Roundtable

Business lobbyists concede that the environmentalists "have been very effective in promoting their cause," as Quarles puts it. But they complain that the green lobby's tactics—especially its skillful use of the press—have distracted attention from the need to devise more efficient, less costly ways of meeting environmental objectives. Businessmen's frustration was captured in a May 7 mailgram on the Clean Air Act sent to members of the Business Roundtable by U.S. Steel Chairman David Roderick, who heads the Roundtable's environment task force. "Despite past efforts, we have failed . . . to offset the work of the environmental community," Roderick wrote. He warned that if business doesn't press its views more effectively, "it is possible that the environmental community will have earned a highly publicized and stunning victory that could frustrate regulatory reform efforts for the balance of this Administration."

The emergence of an environmental lobby capable of engineering such upsets is a relatively recent development. Fifteen years ago the environmental movement consisted mainly of hunters, fishermen, bird-watchers, and other outdoor enthusiasts interested primarily in national parks, wildlife refuges, and other matters directly affecting their sporting interests.

In the late Sixties and early Seventies, this movement was transformed by the explosion of public interest in pollution

and man's use and abuse of nature. A lot of new environmental groups were organized and the lobby expanded its focus to embrace "almost all of society's and nature's activities—from the fate of the desert pupfish to that of an interstate highway, from soil erosion to the sonic boom," according to Rice Odell, an editor at the Conservation Foundation.

After a period in the mid- and late Seventies when the movement's growth slowed, the green lobby took off again. Except for the Izaak Walton League, the National Parks & Conservation Association, and the Wilderness Society, all of the groups that form the inner club of the environmental lobby are substantially larger now than they were in 1970. The National Audubon Society has more than doubled over this period, the Sierra Club has almost tripled, and the National Wildlife Federation has added 250,000 associate members. Many smaller groups have gone from practically zero to 30,000 to 50,000 members over this period.

Today, these groups' total membership of more than five million members, though well under the ten-million-plus members claimed by the National Right to Life Committee, makes the environmentalists an imposing force. By comparison, the National Rifle Association has 2.4 million members and the National Organization for Women a mere 214,000.

Blue-collar greens

The members of most of these groups tend to be better educated and more affluent than the average American. A recent survey of Sierra Club members found that they have a mean income of $38,000 and that almost 40 percent have a graduate degree. On the other hand, the more than one million affiliate members of the National Wildlife Federation are "definitely blue-collar types," according to a Federation spokesman. Though low-income and minority groups are underrepresented, the movement cuts across a fairly broad swath of American society.

The environmental lobby's resources in Washington have also grown enormously. In the late Sixties there were only two or three registered environmental lobbyists on the Hill. Today there are over 80.

As the staffs have grown, they have also become more professional. Together, the Natural Resources Defense Council, the Environmental Defense Fund, the National Wildlife Federation, and the Sierra Club Legal Defense Fund employ about 50 lawyers. Many of NRDC's lawyers went to Harvard or Yale law schools, and all of the 14 lawyers working for the Environmental Defense Fund were on law review. Most were also first in their law school classes.

Environmental groups are making increasing use of computers to quickly target those most likely to help out with a phone call or letter to a key Congressman on the eve of an important vote. The Sierra Club first started using computers in this way during the fight for the Alaska Lands Act in the late Seventies; the Audubon Society and others are more recent converts. William Butler, current director of the Audubon Society's Washington office, recalls that as recently as two years ago,"there were only four or five full-time employees in this office, and people were hand-addressing letters." Now Audubon has a Washington staff of 20, including 13 professionals, and its office boasts word-processing equipment and a computer bank containing the names of more than 50,000 members who have expressed interest in getting involved.

Along with this expansion has come a sharply increased commitment to lobbying. Audubon's Brock Evans, who used to work for the Sierra Club, recalls that in the early Seventies "it was hard to get Audubon or the National Wildlife Federation actively involved" in major fights. By contrast, last year Audubon sent out a letter announcing that it was "entering a battle" with the federal government to prevent "the irrevocable destruction of much of America's natural heritage." The letter brought in almost $1 million in contributions—about ten times more than earlier fund-raising appeals had generated.

The greening of the Audubon Society and the National Wildlife Federation has been accompanied by a dramatic change in the ability of the various environmental groups to work together. In the early Seventies "there was a lot of turf fighting and some of the heads of the different groups couldn't work together," says Louise Dunlap, head of the Environmental Policy Center. But many of the groups have appointed new leadership in recent years, and since Reagan took office, Dunlap says, "the leaders have made a special effort to work together." For the past two years the heads of ten key environmental groups have been getting together about once a quarter to discuss common problems and strategies.

Killing Clinch River

This ability to cooperate is apparent in the environmentalists' extensive use of coalitions that include non-environmental groups. The most impressive example to date—and the effort that perhaps best demonstrated that the environmentalists had become a superlobby—was the campaign they waged in the late Seventies to preserve millions of acres of Alaskan wilderness. By 1980, when the effort succeeded, environmentalists had attracted more than 50 groups into the Alaska Coalition and built a network of thousands of volunteers around the country.

A similar approach is being taken by the Clean Air Coalition, which includes the American Lung Association, the League of Women Voters, the United Steelworkers of America, and the National Urban League. Meanwhile, environmental groups have been working with the conservative National Taxpayers Union and several church groups and unions to kill the Clinch River breeder reactor. That effort has been going so well that a lobbyist for the Taxpayers Union says, "We absolutely expect to defeat it this year."

The impact of the environmental lobby has been greatly magnified by the public's continued support for environmental protection. Pollster Louis Harris noted last fall that in 1967 the public opposed—by 46% to 44%—paying just $15 more per year in federal taxes to finance efforts to fight air

WHO'S WHO IN THE GREEN LOBBY

Group Headquarters	Founded	1982 Budget (millions)	Members	
MASS ORGANIZATIONS				
National Wildlife Federation Washington	1936	$37.1	4,200,000	Mainly hunters and fishermen. With recent sharp criticism of James Watt, it has broken from traditionally conservative posture.
National Audubon Society New York	1905	$22.0	470,000	Onetime bird-watchers now keep eagle eye on all outdoors under Russ Peterson, ex-head of U.S. Council on Environmental Quality.
Sierra Club San Francisco	1892	$13.0	311,000	Most activist big group—also the oldest. Works on local as well as national issues. Membership chiefly western, liberal, and Democratic.
LITIGATORS				
Natural Resources Defense Council New York	1970	$4.5	40,000	Founded by lawyers. Lobbies as well as litigates. A staffer chairs National Clean Air Coalition.
Environmental Defense Fund New York	1967	$2.8	50,000	Produces scientific and economic analysis for litigating and lobbying on local and national levels.
CONFRONTERS				
Friends of the Earth San Francisco	1969	$1.3	30,000	A Sierra Club spin-off. Aggressively anti-nuclear. Has led fight against Clinch River breeder reactor.
Environmental Policy Center Washington	1972	$1.1	—	Has more registered lobbyists (19) than any other environmental group in Washington.
SPECIALISTS				
The Wilderness Society Washington	1935	$3.6	68,000	Focuses on public-lands issues, making a specialty of Alaska. Is branching out into economic analysis.
Defenders of Wildlife Washington	1925	$2.3	56,000	Works to protect endangered species. Often opposes hunting.
Solar Lobby Washington	1978	$1.0	53,000	For tax incentives to conserve energy. Promotes use of renewable energy.
The Izaak Walton League of America Arlington, Va.	1922	$1.3	50,000	A fishermen's organization, it now concentrates on broad water and public-lands issues.
National Parks & Conservation Assoc. Washington	1919	$1.3	35,000	Has refocused efforts on establishing local citizen groups to support parks.
Environmental Action Washington	1970	$0.7	25,000	Sponsored Earth Day 1970, 1980. Its annual "filthy five" campaign vilifies alleged corporate polluters.
POLITICOS				
League of Conservation Voters Washington	1970	$0.9	30,000	The green lobby's PAC, it is spending $450,000 on conservation-minded candidates this year.

The environmental lobby is like a club, and these 14 groups are its members. The many "animal groups," such as the Whale Center, aren't included, and neither are non-lobbying research organizations like the Conservation Foundation. The National Wildlife Federation's membership includes contributors and magazine subscribers as well as dues-paying members. Budgets include funds for activities like magazine publishing, which are often substantial.

BEST AVAILABLE COPY

Terry Ashe

Nothing has exercised environmentalists more lately than Ronald Reagan's Interior Secretary, James Watt. Last October the Sierra Club presented Congress with a petition for Watt's removal that was signed by 1.1 million people.

and water pollution. By 1971, however, "Americans listed pollution control as a national problem second only to the state of the economy." This public support hasn't faded as Americans have learned how expensive clean-up programs can be. Instead, according to a survey conducted by the Roper Organization last September, only 21% of Americans "think environmental protection laws and regulations have gone too far," while 69% say they are about right or haven't gone far enough.

Equally impressive is the breadth of this support. The Roper survey found that no more than 30% of any major group—including Republicans, conservatives, poor people, blacks, and Westerners—felt that "environmental protection laws and regulations have gone too far."

The environmental lobby has been able to capitalize on the support for environmental protection by skillfully using the press. For example, when Democratic Representative Thomas Luken of Ohio and five other House members introduced a series of industry-supported amendments to the Clean Air Act last December, they claimed their bill would reduce the cost and complexity of the act, while "maintaining a strong federal commitment to environmental protection." But these claims were quickly overwhelmed by the Clean Air Coalition's charge that the amendments were "a dirty-air Christmas present for the nation."

Blowing smoke over CO emissions

These tactics have distorted the public's perception of what is at stake in some of the individual amendments. One such amendment, sought by the auto industry, would have changed the standard for carbon monoxide emissions from the current 3.4 grams per mile to 7 grams per mile, which was the standard 1980-model-year cars had to meet. Such a change was recommended by the bipartisan National Commission on Air Quality—which concluded it would not hurt efforts to clean up the nation's air by 1990. General Motors calculates that it could save $60 on every car if the change were adopted; applied industry-wide, these savings would amount to hundreds of millions of dollars a year.

Days before the Senate Environment Committee was to consider this amendment, the Clean Air Coalition unveiled a study that concluded that if the CO standard were changed, "at least 16 major metropolitan areas containing over 40 million people may never meet the public health standard for CO." One of those areas was Albuquerque, New Mexico. The next morning there were banner headlines in Albuquerque warning that the city would never achieve clean air if the CO standard were lowered. The tactic worked: Republican Senator Pete Domenici of New Mexico, a key swing vote, asked that the committee postpone the vote on the standard.

The committee's staff later took a close look at the Clean Air Coalition's study and found that it had merely used more pessimistic assumptions than those used by the National Commission on Air Quality. Though this doesn't prove the coalition's study was inaccurate, it does show how much uncertainty bedevils efforts to project what a 7-gram vs. a 3.4-gram standard would mean for air quality in future years. But this uncertainty—as well as the question of whether the nation should pay hundreds of millions of dollars for the benefits, whatever they might be, of a 3.4-

continued

"We are trying to grope for a new strategy, but we honestly don't have one now," says one business lobbyist.

gram CO standard—was never really communicated to the public. Nor did the general public understand that even with a 7-gram standard, CO levels would continue to fall sharply as Americans traded in older cars that emit far more than 7 grams of CO per mile. Instead, the public was left with the impression that Detroit wanted to sacrifice the goal of clean air by "doubling" the CO standard. As an auto industry lobbyist admits, "The Clean Air Coalition has made very effective political use of these numbers."

The green lobby's clout on Capitol Hill has been so awesome that the Reagan Administration backed away from proposing bills that would make major changes in the Clean Air and Endangered Species acts. But the lobby claims to have had substantially less success in persuading the Administration to adopt its agenda in other areas, especially on public-lands issues and the enforcement of environmental laws. Says Wilderness Society Chairman (and former Senator) Gaylord Nelson: "We are witnessing a wholesale dismantling of the environmental achievements and gains of the past decade and a half. It is being done by a series of executive and administrative actions, without review by Congress, and beyond the view of the American people."

"Boy, did we miscalculate"

That kind of rhetoric has served as a launching platform for the most aggressive environmental campaign ever—the effort to get Reagan to fire Watt, which has broadened into an unprecedented across-the-board attack on the Administration as a whole. Meanwhile, environmentalists are gearing up for the largest push in their history to elect friendly candidates to Congress. The League of Conservation Voters—by far the largest of the five environmental political action committees—plans to back about 70 candidates this fall with a budget of close to $900,000, twice what it had for the 1980 elections. It will also deploy hundreds of enthusiastic campaign workers. Marion Edey, League director, admits that environmental issues play a minor role in many races. But she says, "The environmental movement has only just begun to tap its political potential."

At this point, most business lobbyists are still recovering from their surprise at how well the environmentalists have been doing. "We honestly thought the debate on the Clean Air Act would be less emotional than it was," admits Albert Fry, the lead Clean Air lobbyist for the Business Roundtable. Adds Harvey Alter, a U.S. Chamber of Commerce staffer: "We were blind-sided by an emotional and dishonest attack on any proposal for change. Boy, did we miscalculate."

Some business lobbyists put part of the blame on the Administration. "There is no question that Jim Watt set back progress with some of the statements he made," says John Quarles. All agree that the environmentalists didn't help by, as Alter puts it, "viewing everything we proposed as the biggest threat since Attila the Hun."

But business lobbyists have no very clear ideas about what to do next. "We are trying to grope for a new strategy," says the Roundtable's Fry, "but we honestly don't have one now." Alter is more caustic: "I haven't heard one good idea for anything that can be done in the short term—that is, in time for the next Congress."

There is, however, a general belief that business must learn how to communicate its proposals better. That means, according to Quarles, that businessmen need a "much stronger commitment to genuine public education" regarding the problems and excesses of current environmental regulation, and how to correct them while still meeting basic environmental goals. American Mining Congress President J. Allen Overton Jr. says: "If business is to educate the public about responsible environmentalism, it has to begin with a dialogue with the media, because the media must accept blame for much of the distortion in the people's present perception."

Thus, as Quarles concludes: "Business does have a dilemma." If it fights the new green giant, it is apt not only to lose, but to harm its cause in the process. If it does nothing, it stands to gain nothing. The dilemma is made worse by the fact that the environmentalists are in no mood to be merciful. They are almost as surprised and impressed as are businessmen by the green lobby's new power.

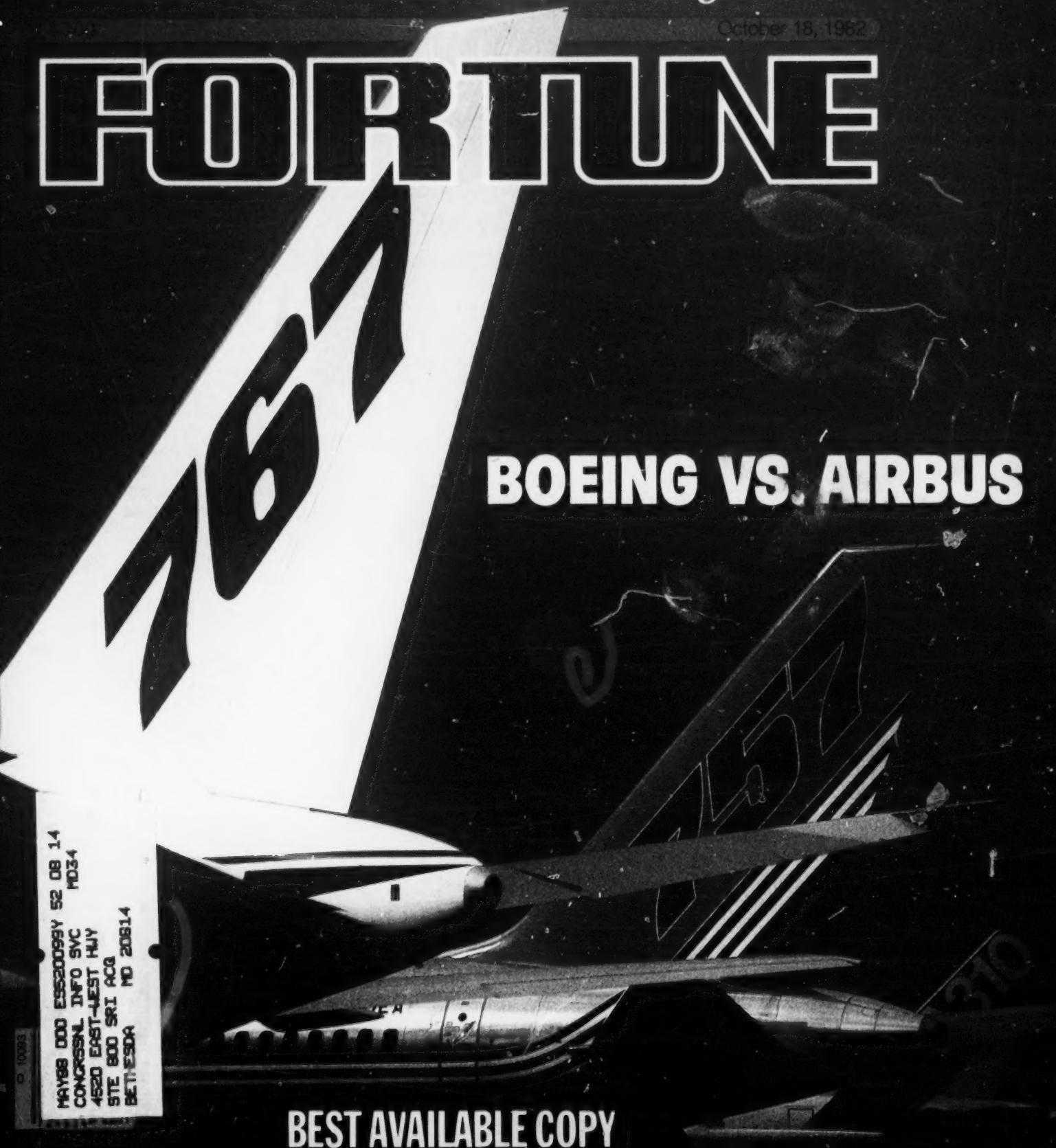
The National Wildlife Federation campaigned successfully to have 1982 declared the year of the eagle. As part of this effort, Senator David Durenberger, a Minnesota Republican, is shown a bald eagle that was nursed back to health by a team of St. Paul veterinarians.

Terry Ashe

Behind the Lines in the Bendix War
Bob Dole Wants to Raise Your Taxes Again

October 18, 1982

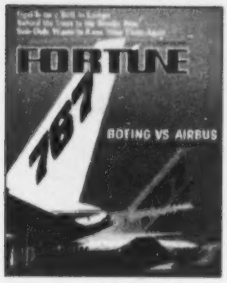
FORTUNE



MAY88 000 E3S20099Y 52 08 14
CONGRSSNL INFO SVC MD34
4520 EAST-WEST HWY
STE 800 SRI ACQ
BETHESDA MD 20814

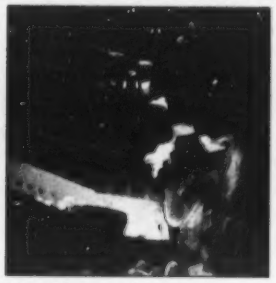
BEST AVAILABLE COPY

FORTUNE



The middleweight contenders for the world aircraft market—Boeing's 757 and 767 and Airbus Industrie's A310—were photographed at the Farnborough Air Show in England by Ian Berry of Magnum. Articles on pages 114 and 121 appraise the combatants' strengths and weaknesses.

126 Dole



148 Hungarian Farm

172 Chips

Departments

4 THE EDITOR'S DESK

7 IN THE NEWS
Xerox's curious $1.6-billion move into insurance, **Sedco**'s offshore rigs stay busy in a drilling downturn, **Tosco** after the collapse of its shale-oil project, **Pan Am** retrenches, **Union Pacific** welds a powerful new rail system—and more

85 LETTERS TO FORTUNE
On Grumman's comeback, the executive recession, Beatrice's lust for bigness, corporate charity, and other matters

97 FORTUNE FORECAST
Into a third quarter of slow growth
Housing lags behind the recovery

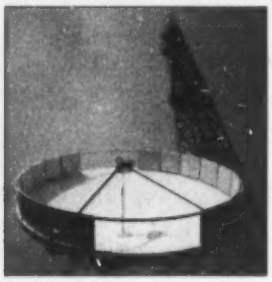
ACKNOWLEDGMENTS

4—Sylvia Plachy. 8—Courtesy Sedco Inc. 97,98—Chartmakers Inc. 116—Chart by Jon E. Herrmann. 128—Upper right photo by Dirck Halstead for Time, bottom photo by Brad Markel for Time. 158—Courtesy Martin Marietta. 213—Chart by Patricia Byrne, illustration by Anders Wenngren.

FORTUNE (ISSN 0015-8259), October 18, 1982, Vol. 106, No. 8. Issued biweekly by Time Inc., 3435 Wilshire Blvd., Los Angeles, Cal. 90010. Second-class postage paid at Los Angeles, Cal., and at additional mailing offices. Subscriptions: U.S., U.S. possessions: one year $36; Canada: one year $46; elsewhere: one year $42 to $70. Single copy $3. Address all subscriptions and correspondence concerning them to FORTUNE, 541 North Fairbanks Court, Chicago, Ill. 60611. Principal offices: Time & Life Building, Rockefeller Center, New York, N.Y. 10020. Address correspondence concerning editorial material to FORTUNE, Time & Life Building, Rockefeller Center, New York, N.Y. 10020. J. Richard Munro, President, J. Winston Fowlkes, Treasurer, Charles B. Bear, Secretary. Authorized as second-class mail by the Post Office Department, Ottawa, Canada, and for payment of postage in cash; Mexico: Autorizado como correspondencia de segunda clase—registro DGC-Num. 051 0881, características 226251415, por la dirección general de correos de México. Responsable en México para efectos postales: Carlos Ruz Pliego, Leibnitz 13, México D.F. 11590. Member, Audit Bureau of Circulation. POSTMASTER: Send address changes to FORTUNE, Time & Life Building, 541 North Fairbanks Court, Chicago, Ill. 60611. © 1982 Time Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. FORTUNE is a registered mark of Time Incorporated.

October 18, 1982

182 Ford



205 Public Radio

103 KEEPING UP
Mike Hammer moves left, technical analysis strikes out, a raw deal at Harvard, and other matters
by Daniel Seligman

213 PERSONAL INVESTING
Why zero-coupon Treasury securities are hot
by Peter D. Petre

219 ON THE ROAD
Hotels with extra-service enclaves
by Thomas Moore

231 BOOKS AND IDEAS
Why we are Hamilton's heirs
by Andrew Hacker

237 OFFICE HOURS
A new boss parachutes in
by Walter Kiechel III

AIRCRAFT
114 Boeing's New Beauties Are a Tough Sell *by Alexander Stuart*
The company that shaped the jet age may have built the wrong mix of planes at the wrong time.

121 Airbus Is Rough Competition *by Robert Ball*
The European consortium has been landing most of the new orders for big planes.

TAXES
126 Bob Dole Wants to Raise Your Taxes Again *by Juan Williams*
And he may. The Senate Finance chairman has proved adept at welding coalitions to do the undoable.

141 Taxing the Business Lobby's Loyalty *by Richard I. Kirkland Jr.*
The Administration's battle to raise revenues has alienated some of its staunchest allies.

PICTURE PORTFOLIO
148 Hungary's High-Tech Farm
Cash incentives and U.S. know-how make crops flourish along the Danube.

TAKEOVERS
156 Behind the Lines in the Bendix War *by Roy Rowan and Thomas Moore*
When Bill Agee set out to conquer Martin Marietta, he underestimated its ASSCAP (Assured Second Strike Capability).

An Interview with Bill Agee and Mary Cunningham

TECHNOLOGY
172 The Chip That Erases Repair Bills *by Gene Bylinsky*
Reprogrammable and endowed with a permanent memory, it opens up countless new computing possibilities.

CARS
182 Ford Is on a Roll in Europe *by David B. Tinnin*
Profitable operations on the other side of the Atlantic are repatriating money, management talent, and ideas to Dearborn.

195 A Golden Oldie Is Detroit's New Hit *by Ann M. Morrison*
Convertibles built with the help of outsiders are selling surprisingly well.

BROADCASTING
205 Public Radio Comes to Market *by William Tucker*
With government money drying up, the nonprofit network is considering all sorts of business deals.

The Administration's battle to raise revenues has alienated some of its staunchest allies.

Taxing the Business Lobby's Loyalty

by RICHARD I. KIRKLAND JR.

If Ronald Reagan, like Bob Dole, decides that federal revenues need enhancing again next year, he'd better not count on a lot of business support. Contrary to Administration claims, when Reagan switched from tax cutting to revenue raising this summer, most of his business allies from previous legislative battles also switched—from support to opposition or sullen silence. Any renewed drive for higher taxes could make the sullen less silent and the opposition more effective.

Last year the business lobbyists massed behind the President's tax cuts numbered more than 500 and had to hold their meetings in the cavernous Hall of Flags at the U.S. Chamber of Commerce. This year the lobbyists supporting the call for $98 billion in tax increases barely exceeded 100 and fit quite comfortably into the boardroom of the National Association of Home Builders. Even the minority who backed the President's proposals didn't have much to say for them. "Everybody," asserts the head of one large trade association, "thought this was a bad bill."

The businesses that did organize on behalf of raising taxes—a coalition wryly tabbed the Deficit Reduction Action Group (DRAG)—were drawn together by John Albertine, president of the American Business Conference, a group of 85 medium-size high-growth companies. The name DRAG was Albertine's idea. A strong advocate of last year's tax cuts, Albertine justifies his support for this year's takeback as a matter of politics rather than sound economics. "In terms of substantive economics," he says, "there's no good justification for this bill. This is simply castor oil that had to be taken to persuade moderate and liberal Democrats to vote for the spending reductions we really need to bring interest rates down." Albertine also candidly admits that since his member companies gained relatively less than many big, capital-intensive companies from last year's tax bill, they had relatively less to lose from this one.

Research associate: Monci Jo Williams

Aware of what they were up against, the strategists at the White House decided to focus their business lobbying on silencing potential opponents rather than on winning friends. Says Wayne Valis, the White House point man for business liaison: "Neutralizing the opposition was our top priority." In pursuit of that goal, aides say, President Reagan made around 30 phone calls and held private audiences with businessmen who represented "the real hardcore opposition." Paul Thayer, head of LTV and chairman of the 260,000-member U.S. Chamber of Commerce, came in for special attention because the Chamber was the most vocal center of business resistance. To undercut it, the White House issued urgent appeals to the officers and members of some 1,200 state and local chambers, asking them to support Ronald Reagan and ignore the calls to opposition coming from Chamber President Richard Lesher and his Washington staff.

Lots of pulled punches

Such tactics paid off. Although only 30-odd local chambers came over to the President's side, many more remained mum. Thayer, with strong White House assistance, managed to convince 32 of the 61 board members to back Reagan rather than Lesher.

The only other trade associations willing to break publicly with the Reagan Administration—the National Federation of Independent Business, the American Farm Bureau Federation, the National Association of Wholesaler-Distributors—were unwilling to offer much more than token resistance to new taxes. Their normally powerful grass-roots lobbying machines barely sputtered. "We never got to our whirling-dervish stage," admits Dirk Van Dongen, president of the wholesalers' association. Exults Wayne Valis: "We got lots of guys to pull their punches."

Straightforward dealmaking kept some businesses quiet. "Our hearts were with Jack Kemp on this," says William Anderson, chief lobbyist for the Independent Petroleum Association. But in exchange for a provision exempting independent oilmen from new taxes on oil, the IPA followed its head rather than its heart and stifled its objections to the bill.

Other deals even converted some abstainers into active advocates. The Direct Selling Association and its members—door-to-door purveyors of plastic kitchenware, encyclopedias, and cosmetics—backed the bill because it clarified their cherished status as "independent contractors." The Internal Revenue Service had been arguing that many such salesfolk were actually company employees and that thus their suppliers should pay Social Security and unemployment taxes. By not increasing excise taxes on hard liquor or imposing new oil import fees, the Administration also convinced the Distilled Spir-

continued

BEST AVAILABLE COPY

WHO GOT HIT HOW HARD
EFFECTIVE TAX RATES IN 1986 ON RETURNS FROM NEW INVESTMENT

	1982 LAW	1981 LAW	1980 LAW
SERVICES AND TRADE	40.0%	33.2%	53.1%
UTILITIES	33.4%	20.7%	42.5%
FOOD	26.7%	13.6%	43.5%
MACHINERY	25.7%	10.6%	38.2%
AGRICULTURE	22.5%	5.9%	31.7%
COMMUNICATIONS	21.4%	-0.2%	38.8%
CHEMICALS	17.7%	-2.4%	28.6%
PRIMARY METALS	15.7%	-1.5%	34.6%
PETROLEUM REFINING	13.0%	-13.2%	35.4%
MINING	12.6%	-24.6%	28.4%
TRANSPORTATION	12.2%	-19.9%	31.0%
PULP AND PAPER	11.8%	-12.2%	28.8%
MOTOR VEHICLES	9.0%	-38.6%	26.0%
ALL INDUSTRIES	28.4%	13.1%	42.2%

The Great Tax Takeback of 1982

Congress giveth and Congress taketh away—with help from the Reagan Administration. The American Council for Capital Formation estimates that when the effects of the 1982 tax act are calculated to 1986, the act negates 57% of the business tax relief granted last year.

The table above summarizes the damage by industry. It shows estimated effective tax rates in 1986 on returns from new investment in plant and equipment. Why 1986? That's when the accelerated depreciation provisions of the 1981 tax act would have become fully effective. The figures were compiled for FORTUNE by the Treasury's Office of Tax Analysis. OTA assumed, among other things, that companies are able to take full advantage of the accelerated depreciation and investment tax credits available to them.

Those minus signs in the 1981 column indicate that a lot of companies would have been able to write off more than the costs of the assets they purchased. This generosity led to a lot of raised eyebrows, and now all the minus signs are gone. Even so, most companies in the industries listed are better off, in tax terms, than they were under the laws in effect at the end of the Carter Administration. Some experts, however, say that when all the multitudinous provisions of the Tax Equity and Fiscal Responsibility Act of 1982 are taken into account, it is possible for some companies to be worse off than if the Reagan Administration had just left things the way they were in 1980. —PHILIP MATTERA

its Council and New England business groups that raising other people's taxes was a good idea.

Harder to explain is the capitulation of some big winners from last year's tax cuts—capital-intensive companies like GM, Ford, Chrysler, Westinghouse, Armco, Bethlehem Steel, Eastern Air Lines, Greyhound, LTV, and Phillips Petroleum. These firms and their Washington agents—such as tax lobbyists Charls Walker and Ernest Christian—were principal architects of the accelerated-cost-recovery system (ACRS), which speeds up depreciation schedules, and the so-called safe-harbor leasing rules, which allow ailing firms to sell their unused tax breaks. By putting new limits on the investment tax credit, repealing increases in ACRS benefits scheduled for 1985 and 1986, halving the benefits of safe-harbor leasing and then abolishing it altogether as of January 1, 1984, Congress went a long way toward wiping out the value of the tax incentives for capital formation it granted just last summer.

Yet all but two businessmen on the 24-member executive committee of the National Association of Manufacturers supported the President. So did all but a few members of the Business Roundtable's policy committee. Even the American Petroleum Institute, whose members lost part of their intangible drilling deductions and foreign tax credits, overcame "considerable division" and backed the bill.

What's more, several prominent chief executives—Chrysler's Lee Iacocca, GM's Roger Smith, Ford's Phil Caldwell, LTV's Paul Thayer, Goodyear's Charles Pilliod—gave the bill their public blessing days before they knew whether the crucial amendments that they were pushing in the House-Senate conference committee would be included in the final legislation. (They weren't.)

The fear factor

In explaining these defeatist tactics, the executives and lobbyists involved speak of high principle—"the need to support the budget process" or some such. Seldom acknowledged is their deeper reason—fear. Unlike broad-based membership organizations such as the NFIB or the Chamber of Commerce, big corporations and individual chief executives can be made to feel vulnerable—to particularly stringent regulatory or antitrust scrutiny, perhaps, or to loss of a big government contract, even to hostile public opinion. The Administration used this sense of vulnerability. Says a lobbyist: "The White House was telling people they weren't going to get shit the next time they came in if they didn't support the President."

With huge federal budget deficits still looming ahead despite the tax increases, many Washington business lobbyists are already starting to think about what the next round of "tax reform" will look like. In hopes of striking a better deal next time, some lobbyists have begun mapping out a positive proposal for reviving the kind of activism and unity that served them so well in 1981. Jack Albertine reports that the morning after Congress approved the new tax bill, Charls Walker sent him a note suggesting they get together soon "to discuss strategy." In view of what happened to business this year, it hardly seems too soon to start. F